



County of Los Angeles
CHIEF ADMINISTRATIVE OFFICE

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DAVID E. JANSSEN
Chief Administrative Officer

April 7, 2006

To: Mayor Michael D. Antonovich
Supervisor Gloria Molina
Supervisor Yvonne B. Burke
Supervisor Don Knabe
Supervisor Zev Yaroslavsky

From: David E Janssen
Chief Administrative Officer

Board of Supervisors
GLORIA MOLINA
First District

YVONNE B. BURKE
Second District

ZEV YAROSLAVSKY
Third District

DON KNABE
Fourth District

MICHAEL D. ANTONOVICH
Fifth District

IRS NOTICE REGARDING TERMINATION PAY CONTRIBUTIONS TO TAX DEFERRED PLANS

The Internal Revenue Service (IRS) has orally notified the County that it will likely change its longstanding position on Internal Revenue Code provisions key to permitting employees to obtain a tax deferred status on termination pay. This will effectively nullify the legal basis currently used to convert compensation for unused vacation time, sick leave, and other termination pay into a tax deferred employer contribution to the Termination Pay Pick-Up Plan or, alternatively, the Savings Plan. It would also nullify the use of tax deferred termination pay to purchase up to five years of additional retirement credit (commonly known as "ARC") from LACERA. We expect the IRS to issue a Revenue Ruling, akin to a policy mandate, later this year.

In light of this development, the Plan Administrative Committees for the Termination Pay Pick-Up Plan and the Savings Plan will be convening a joint emergency meeting on April 13, 2006 to determine the appropriate action to be taken pending a formal ruling from the IRS. The Chief Administrative Office representatives attending this meeting will recommend that the Plans immediately suspend the acceptance of new termination pay sign-ups. They will also recommend that the existing sign-ups continue to be honored until we have more definitive information from the IRS. Under the County Code provisions pertaining to these plans, the Administrative Committees are empowered to make these decisions. No Board action is required at this time.

It should be noted that employees who have already signed-up under the Termination Pay Pick-Up Plan and the Savings Plan were required to undergo one-on-one counseling regarding the legal status of the program. This included an explanation of the fact that the County has been relying on general guidance from the IRS in this area,

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including rulings affecting other pick-up plans. The employees were informed that a ruling request specific to the County was in progress, but that no response from the IRS had yet been received. They were also informed as to the potential consequences of an adverse ruling relative to their individual situation, and they were required to sign a release of liability protecting the County in the event of an adverse ruling. To date, approximately 832 employees have applied to the program. Of these, approximately 24% have already terminated and either withdrawn their funds, begun receiving ARC inclusive service distributions, or rolled over to an IRA or other tax deferred programs.

LACERA staff has stopped taking new applications using termination pay to purchase ARC. They will continue to honor and process existing ARC agreements. The Board of Retirement is expected to endorse these actions during their regular April 13, 2006 meeting.

If you have any questions, please call me or your staff may call David Turla of my office at (213) 893-2377.

DEJ:SRH
WGL:DT:df

c: Auditor-Controller
County Counsel
Department of Human Resources
LACERA
Treasurer and Tax Collector
Annelle Grajeda, Local 660
Skip Henke, CCU
Members and Alternate Members, Savings Plan Administrative Committee
Members and Alternate Members, Termination Pay Pick-Up Plan